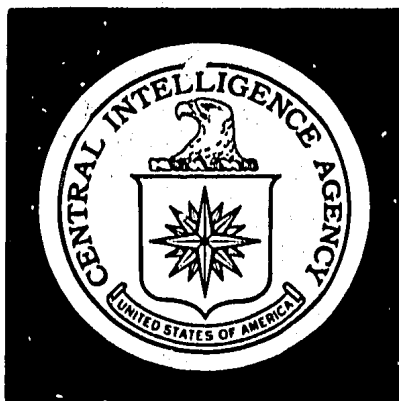


Declassified in Part - 25X1
Sanitized Copy Approved for
Release 2011/10/31 :
CIA-RDP85T00875R00160003

Declassified in Part -
Sanitized Copy Approved for
Release 2011/10/31 :
CIA-RDP85T00875R00160003

~~Secret~~

25X1



DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

US-China Trade Potential

~~Secret~~

ER IM 70-95
July 1970

Copy No. 98

Page Denied

SECRET

25X1

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
July 1970

INTELLIGENCE MEMORANDUM

US-China Trade Potential

Introduction

Economic relations between the United States and Communist China have been virtually nonexistent since US unilateral controls were erected during the Korean War. In the past year, however, the United States has undertaken a limited relaxation of these controls, in part as a signal to China that improved relations are desired. The official Chinese reaction has been negative, but Peking has made some moves to take advantage of these limited opportunities.

In the United States, academic and business reaction has been favorable to the US policy action, but there has been no surge in business inquiries concerning the China market. However, the interest in studying the problems and opportunities of trading with China would be greatly stimulated if significant further relaxations in these controls were made.

This memorandum examines the status of US unilateral controls, including the recent relaxations, and other obstacles to economic relations between the United States and China. It then assesses the potential for US-China trade relations, in terms of possible values and commodities in the two-way trade, under (a) present conditions following the recent relaxations, and (b) conditions where all US unilateral controls were abolished (but COCOM controls were maintained at the present level).

*Note: This memorandum was produced solely by CIA.
It was prepared by the Office of Economic Research.*

SECRET

25X1

SECRET

Origin of US Trade Controls with Communist China

Unilateral Controls

1. In early 1949, as the Chinese Communists began their drive toward south China, President Truman imposed controls on trade with China that became coextensive with controls on shipments to the USSR and Eastern Europe. Following the outbreak of the Korean War, the US Government revoked all outstanding licenses for export to China and thus embargoed all US exports except for some non-strategic products which could be shipped without prior government approval.

2. In December 1950 the US Commerce Department tightened these controls further by requiring written permission for either the direct or indirect export of any goods to China. Two weeks later the US Treasury Department blocked all Chinese assets in the United States and prohibited all imports from and dealings with China. In addition, the Commerce Department then issued transportation orders which forbade aircraft or ships registered in the United States from engaging in the transport of any goods destined for China, and also prohibited them from stopping at any Chinese-controlled areas. Thus, by the end of 1950, the United States had imposed a total embargo on US trade and payment transactions with Communist China. This embargo was to remain relatively unchanged until 1969, when a more relaxed US attitude began to appear.

COCOM Controls

3. Since the embargo would have little effect on China's economic and military potential if strategic materials embargoed by the United States could be obtained from other Free World nations, the United States pressed its COCOM partners in 1950 to extend the existing controls on the Soviet Bloc to China. This was done by July 1950, and after China entered the Korean War the United States tried to extend and make more comprehensive the COCOM controls against the Chinese. Late in 1953 a more comprehensive list of items embargoed for Communist China had been agreed upon, and the so-called "China differential" came into being. It existed from 1953 to 1957.

SECRET

4. In 1968 a review of the COCOM lists was undertaken. Two major aspects of this review concerned (a) more restrictive controls on China than on Eastern Europe and the USSR, and (b) a significant reduction of the list for Eastern Europe and the USSR. In general, the outcome of the list review resulted in a lowering of controls against the USSR and Eastern Europe, while the treatment of China became more of a holding action against relaxation of controls rather than a significant increase in the list of embargoed items. Thus, an outcome of the 1968 list review was the re-establishment of a "China differential."

Recent Relaxation of US Unilateral Controls

5. The first US move to liberalize the embargo against China came on 23 July 1969, when the Treasury Department changed its regulations governing tourist purchases of Chinese goods. The new regulations permitted Americans travelling abroad to purchase up to \$100 worth of Chinese goods as long as these goods were not intended for further commercial use. While this action meant relatively little on purely economic grounds, the political significance of a crack in the embargo wall was clear and it began to generate interest in US business circles. On 23 December 1969 the \$100 ceiling on tourist purchases was removed, individuals and tax-exempt organizations such as museums and universities were permitted to import Chinese items, and corporations organized abroad (including subsidiaries of US firms) and Americans resident abroad were allowed to trade with China and deal in Chinese merchandise.

6. Despite the liberalization of trade restrictions, most potential economic relations between the United States and China are still severely restricted. For example, no merchandise of US origin can be exported to China; no petroleum can be supplied to Chinese vessels; no transactions involving US dollar accounts are permitted; US vessels cannot call at Chinese ports; most technical data are still embargoed for China; and commercial imports of Chinese products are still forbidden. Thus, while the changed regulations permit foreign businesses controlled by US firms to deal in Chinese products, direct commercial US-China trade is still barred.

SECRET

Obstacles to US-China Trade

7. The main stumbling block to US-China trade is the state of political relations between the two countries. On the US side, although trade with China is legally prohibited, administrative action by the President could remove these barriers rather easily. On the Chinese side, political decisions and foreign policy considerations currently inhibit trade with the United States.

8. Another obstacle that would tend to inhibit US trade with China is the lack of knowledge of the China market. No contacts exist between American businesses and Chinese trading organizations, and these would have to be established before significant exchange could take place. In addition, the experience of Western European and Japanese firms trading with China demonstrates that China is neither a reliable market nor a stable source of supply. The yearly switch of Canada and Australia as China's major wheat supplier, as well as current Chinese inability or unwillingness to sell traditional exports of nonferrous metals, illustrates some of the problems that can arise if China is relied upon either as a market for Western goods or a supplier for Western firms. Just as important is the vigorous competition among Western firms for Chinese business. The Chinese are able practitioners of market strategy; consequently, dealing with the Chinese involves confronting traders who are generally well versed in Western market conditions.

9. Aside from political difficulties, however, these problems should not prove insurmountable to US businessmen. Other Free World traders have successfully overcome the same obstacles that US businessmen would encounter. If potential profits were high enough, US businessmen would be induced to trade with China.

Potential Level of US-China TradeBackground

10. The foreign trade of Communist China has long reflected its international political position as well as domestic economic conditions. China, like many less developed countries seeking industrialization, has looked to foreign trade as a

SECRET

source of plant and equipment for its industrial and military development efforts. Since 1960, foreign trade has also served to supplement domestic food production. Although the physical makeup of imports and exports has generally reflected economic goals, the geographical direction of China's trade has been strongly influenced by political considerations.

11. The volume of China's trade is small in relation to total economic activity and is a reflection of limited export capabilities. The size of China's imports does not reflect the magnitude of China's needs or the importance of imports to the development of the economy and the military establishment. China's foreign trade grew steadily from \$1.2 billion in 1950 to \$4.3 billion in 1959. The pattern of trade was dominated by the exchange of Chinese agricultural and mineral products and textiles for machinery and raw materials contributing to the growth of the modern industrial sector. Since 1959 the trend in total trade has been erratic, and both the commodity and geographical patterns of foreign trade have shifted dramatically (see Figures 1, 2, and 3). The primary reasons for these changes are the Sino-Soviet dispute, a desire to obtain the most advanced technology and equipment available, and the need to obtain grain and fertilizer from the West.

12. Although US-China trade is forbidden, the United States generally does permit the exchange of printed matter, exposed motion picture film, and phonograph records. In recent years, US imports from China have consisted of less than \$500,000 per year of antiques, art objects, publications, and other items for consumption. US exports to China have been negligible.

US-China Trade Under Current Relaxations

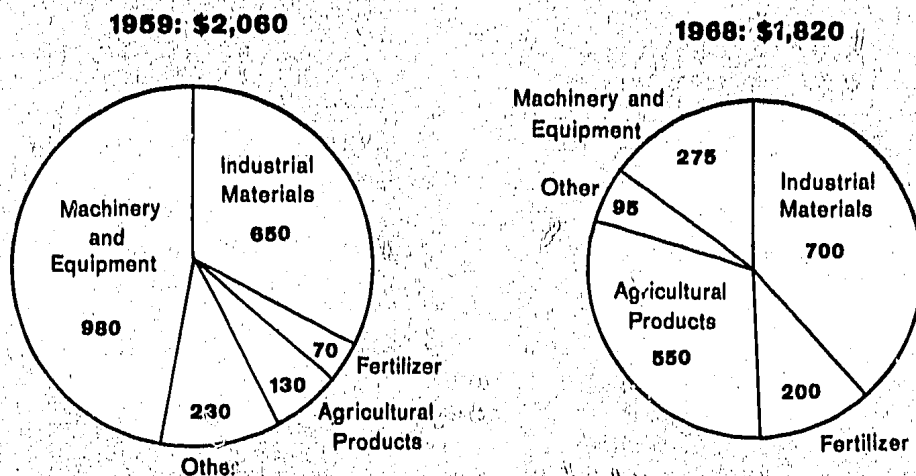
13. Under current restrictions on trade with Communist China, the potential level of US-China trade is small. Aside from limited purchases of Chinese products by American tourists and imports of art objects and antiques by individuals and non-profit organizations, there is little latitude for commercial exchange. Under the current restrictions, such US imports might be some \$10 million per year in the near future. By definition, US exports to China would be zero.

SECRET

Figure 1

Communist China's commodity composition of imports In 1959 and 1968...

Million US \$

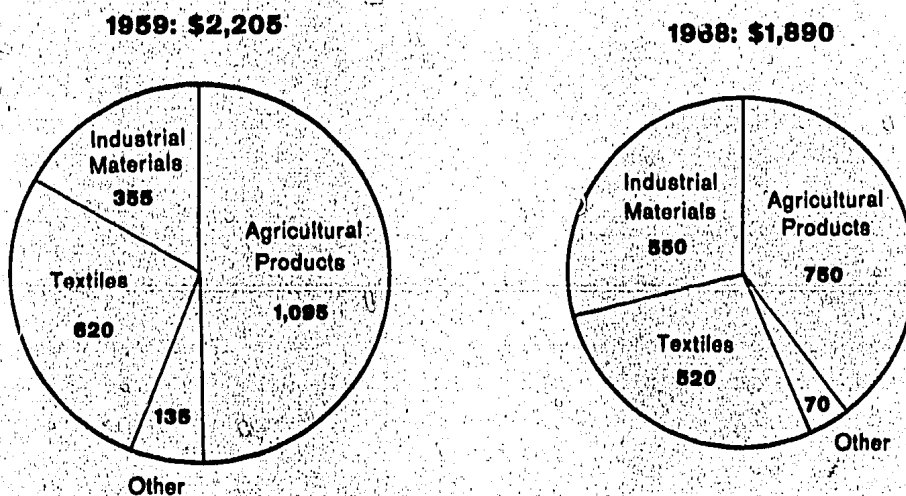


78673 7-70

Figure 2

Communist China's commodity composition of exports In 1959 and 1968...

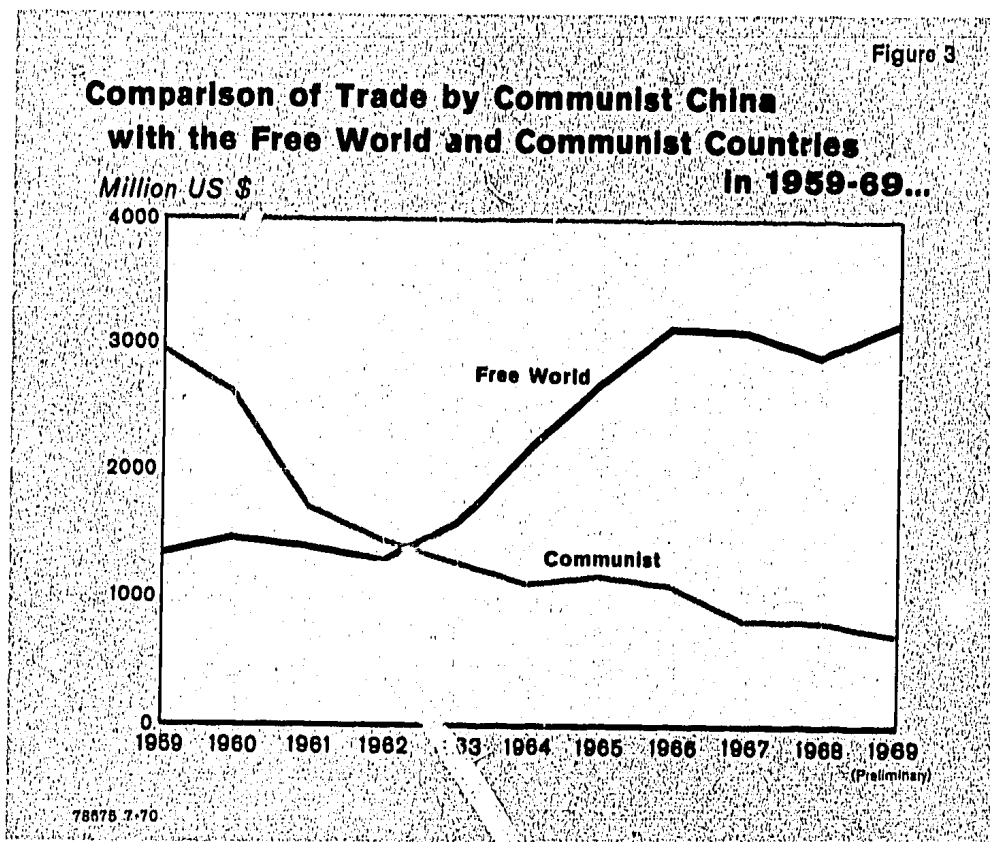
Million US \$



78674 7-70

SECRET

SECRET



14. The Chinese, however, have responded to the recent lowering of restrictions in several ways. After American tourists were permitted to purchase products of Chinese origin, Chinese Communist retail outlets in Hong Kong advertized for English-speaking clerks, put up window displays of luxury merchandise, placed advertisements in the English-language *South China Morning Post*, and offered mail order service. The implication of these activities is an overt but oblique reaction to the cutback in US trade restrictions. Such activities indicate Chinese willingness to sell goods to US citizens.

15. So far, however, China has not shown a desire to trade with US subsidiaries. Two US-affiliated Japanese firms, Asahi-Dow Ltd. and Ishikawagima-Koehring Co., reportedly attempted to get invitations to the Spring Canton Trade Fair, but they were turned down by the Chinese. In addition, Chou En-lai told a group of Japanese on

SECRET

SECRET

19 April 1970 that China does not intend to trade with US enterprises in Japan. If this statement reflects actual Chinese policy, the possibility for business between China and foreign subsidiaries of US firms would be severely limited.

US-China Trade Under No US Unilateral Controls

Potential US Export Commodities

16. The experience of recent years has provided no evidence that China's increased reliance on Free World trade has altered China's unwillingness to trade with the United States. If the United States were to relax its unilateral controls, however, China would probably be quick to purchase a small volume of certain types of industrial goods embodying advanced technology unavailable from other Western sources. It should be noted, however, that for most non-COCOM goods, the technological levels in Western Europe and Japan are on a par with those in the United States. And these countries have the advantage of several years' experience in serving the Chinese market. In addition, China's trade with Eastern Europe and the USSR, which has declined greatly, continues to provide China with some machinery and equipment and metals. Much of the machinery installed in China is of East European or Soviet design and generally requires spare parts from the same source or from domestic production.

17. US firms would also face heavy competition in attempting to sell grain and fertilizer to China. Japan and Western Europe are able to satisfy China's requirements for fertilizer, and Canada and Australia can easily fill China's grain requirements. Thus in the first years after dropping unilateral controls, China's imports from the United States would probably grow at a slower pace than its exports to the United States.

Potential Chinese Export Commodities

18. The US market for Chinese goods has changed drastically since 1950 when the United States accounted for almost \$150 million, or about one-fourth, of China's total exports. In 1950, more than one-third of China's exports to the United States were composed of bristles, tung oil, and feathers -- commodities that the United States

SECRET

no longer imports in large quantities. For Chinese luxury products, however, the US market would be much larger than in 1950 because of the great rise in disposable income. In some cases, these products would be unique and face little competition from domestic or foreign sources. Typical of potential luxury exports would be rugs, embroideries, antiques, art objects, and curios. China might find it difficult to take full advantage of increased US demand for luxury-type goods, however, because it no longer enjoys most-favored-nation tariff treatment in trade with the United States.

19. China would have difficulty achieving large-scale penetration of US markets with its major exports of textiles and staple foodstuffs. In view of longstanding opposition to textile imports, the United States would probably be unwilling to permit large-scale imports of Chinese textiles. While staple foodstuffs would not enjoy a large market in the United States, China could probably sell substantial quantities of specialty foods to American consumers. There would be some market for Chinese exports of consumer products such as tea, silks, and light manufactures. Also, if China were to make available greater quantities of tungsten, tin, and other metals, US firms probably would place orders for these items.

Some Estimates of Potential Trade Levels

20. Two methods have been used to provide some notion of potential levels of US-China trade following an elimination of US unilateral controls.* These levels would take a few years to be reached even under relatively favorable political conditions. The first approach uses a similar trading partner approach. For US exports, West Germany has been chosen as a similar exporting nation. The US export potential is assumed to equal average West German exports for the years 1966-68 plus an allowance of \$100 million for sales of grain. This approach results in expected exports of about \$270 million, composed of grain, \$100 million; chemicals, \$30 million; semi-finished manufactures (chiefly

* *The growth factor in total trade of each country is assumed to cause no significant changes in estimates of potential trade; thus, a downward bias to the estimates is introduced, one which is believed to be too small to be of concern.*

SECRET

metals manufactures), \$85 million; machinery and equipment, \$40 million; and miscellaneous manufactures, \$10 million. A level of \$270 million in US exports implies some diversion of Chinese purchases from Japan and/or Western Europe to US business firms.

21. For China's exports to the United States, per capita US imports are assumed to equal Canadian imports from China on a per capita basis. This results in US imports of about \$200 million, composed of foodstuffs, \$30 million; crude materials, \$30 million; chemicals, \$5 million; semi-finished manufactures (chiefly textile yarns and fabrics), \$65 million; and miscellaneous manufactures (mainly clothing), \$75 million. Because about two-thirds of Canada's imports are composed of textile products, and the import of many of these items would be strongly resisted by US manufacturers, this approach almost certainly overstates US import potential.

22. The second approach is a modification, which attempts to make direct estimates of the likely value of the commodities entering any future trade. Thus, as compared with the first approach, the value of US textile imports is scaled down sharply for reasons noted above. Likewise, the value of US metals exports is cut back on the judgment that these exports would face heavy competition from China's current Free World suppliers. This suggests that, after several years of development, possible US-China trade may be as follows:

	Million US \$
China's exports.	
Foodstuffs	20-25
Bristles and other crude animal materials	10-25
Tung oil, other oils, and chemicals	20-25
Nonferrous metals	10-25
Textiles and clothing	20-25
Antiques, art objects, and pottery	20-25
<i>Total</i>	<i>100-150</i>

SECRET

SECRET

	<u>Million US \$</u>
US exports	
Grain	100
Fertilizer and other chemicals	25
Machinery and equipment	15-40
Metals and other manufactures	35
<i>Total</i>	<i>176-200</i>

23. US sales of grain under this method are assumed to be \$100 million. This would give to the United States the equivalent of one-third to one-fourth of China's current grain market. While this is not unreasonable on economic grounds, the Chinese could easily satisfy their grain needs from Canada and Australia, so actual US sales might well be far below the \$100 million estimate.

24. Other alternative Chinese import policies are of course possible. For example, China might not permit importation of goods from the United States, yet allow the export of goods to the United States. Or, China might insist on balanced trade. Any of these policy actions would affect the level of trade between the two countries.

Conclusions

25. The relaxations of the past year in the US unilateral embargo on trade with China now permit US tourists and individuals and nonprofit institutions to purchase Chinese goods and would allow US subsidiaries abroad to trade with China. While these US policy actions have considerable political significance, they have little economic importance. No direct trade transactions between US business and China are permitted. Purchases by US citizens should continue to rise, but will never be large -- perhaps becoming some \$10 million in a year or two. And the Chinese reaction thus far suggests that US subsidiaries abroad may have to wait some time to reap significant benefits from being permitted to trade with China.

SECRET

26. If the United States were to remove all unilateral controls on trade with China, however, the economic significance of the policy action could be much greater. How much this would stimulate US-China trade lies primarily in the Chinese reaction, basically a political decision. Other obstacles on the Chinese side, such as difficulties in doing business with state trading corporations, would probably be only of a temporary nature. Finding goods marketable in the United States and the existence of established trading relationships with other Free World countries would be additional factors influencing the two-way trade. China is not a major world trading nation, and its trade is likely to increase rather slowly in the next decade. This consideration, plus the factors noted earlier, suggests that US-China trade is unlikely to be large on a commercial basis, even with good state relations.

27. Various estimates have been made on the basis of analogy with other countries currently trading with China and of assumptions concerning US-Chinese political relations. These estimates yield a range of potential two-way trade of \$100 million to \$470 million (\$100 million-\$200 million in Chinese exports and \$0-\$270 million in US exports). Unless political relations between the two countries suddenly improved sharply, US-Chinese trade would likely take several years to build up to even the lower end of this range. While China would move as it has already in its Hong Kong stores to sell more to US citizens and would purchase some US goods where technology and/or price make them a superior buy, China would be slow to permit direct transactions between its state trading corporations and US business. China probably would consider indirect means for handling such trade more acceptable politically.